Supreme Court, U.S.
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No. 03-341

In The

Supreme Court of the United States

ALLSTATE INSURANCE COMPANY,

Petitioner,

v.

WILLIAM NOAH, TERRY NOAH, GEORGE GIAKOUMAKIS, MARY LOU GIAKOUMAKIS, CHERYL MONDHEIM, JAMES HOUSE, and PAT HOUSE,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY

Pursuant to Supreme Court Rule 15(6), petitioner Allstate Insurance Company respectfully submits this reply to new points raised in respondents' opposition to the petition for certiorari.

I.

IMMEDIATE REVIEW IS ESSENTIAL, BECAUSE THE PASSAGE OF TIME ALONE WILL DEFEAT THE CONSTITUTIONAL RIGHT AT ISSUE

As respondents concede, this Court's power of review does not depend on whether the decision below is final. Although this Court may deny interlocutory review in "the interest of judicial economy," *Estelle v. Gamble*, 429 U.S. 97, 115 (1976) (Stevens, J., dissenting), the Court grants interlocutory review in appropriate cases. *See, e.g., Randolph Central School Dist. v. Aldrich*, 506 U.S. 965 (1992) (White, J., dissenting) (citing numerous examples of cases granting interlocutory review).

Here, interlocutory review is essential because deferring review would irretrievably destroy the constitutional right at issue. The petition concerns the rights not just of Allstate in this one case, but of all insurers who have been compelled to reopen thousands of closed Northridge earthquake claims. The cost of investigating such claims, defending the associated litigation, and making further payments in some cases, is estimated to be as high as $500 million. Amicus Brief of 21st Century Insurance Company, p. 1. Yet the right to be free of such costs is the essence of the contractual right of repose that California Code of Civil Procedure § 340.9 has taken from these insurers. Once such money is spent on investigation and defense, it cannot be retrieved. Thus, only prompt review can give force to the Contract Clause and restore at least some of

the benefit of the contractual right of repose. Denying review until litigation is final and the last dollar is spent would deny the affected class any prospect of meaningful relief.

II.

THE DENIAL OF A PREVIOUS PETITION IN A DIFFERENT PROCEDURAL CONTEXT IS IMMATERIAL

Respondents note that this Court denied certiorari to review a state court decision raising a similar issue in *20th Century Ins. Co. v. Superior Court*, 90 Cal.App.4th 1247 (2001), *cert. denied*, 535 U.S. 1033 (2002). Opposition, p. 6. The Court's action in *20th Century* is immaterial here.

Among other things, *20th Century* involved a petition from a non-final decision of an intermediate state court, where the state's highest court had denied review. Under 28 U.S.C. § 1257 – which imposes jurisdictional restrictions on review of state court decisions that are stricter than the requirements of 28 U.S.C. § 1254 – the Court may simply have concluded that it lacked jurisdiction.

More importantly, *20th Century* arose in a procedural context – a pleading challenge, in which all allegations must be accepted as true – that precluded review of the precise issue raised here. The issue here is whether Section 340.9 is reasonably tailored to its stated goal of protecting insureds who were misled by insurers, given that the statute deprives all insurers of their contract rights in all claims without any requirement that the insured prove deception. *20th Century* could not properly present this issue because the plaintiff there alleged that she had been misled by her insurer, and those allegations had to be accepted as true. *20th Century*, 90 Cal.App.4th at 1256. This petition, in contrast, arises from a summary

judgment. Respondents had the opportunity to present evidence that Allstate misled them, and the Ninth Circuit found that they had failed to do so. App. 9. This case therefore squarely raises that aspect of Section 340.9 which is most repugnant to the Contract Clause.

III.

THE ONE-YEAR LIMITATION PERIOD IS CONTRACTUAL, NOT STATUTORY

Respondents argue that the contractual one-year limitation provision is a creature of statute, not of contract, and thus that Section 340.9 is immune from Contract Clause review. Opposition, pp. 8-10. Respondent is incorrect for several reasons.

First, the premise of respondents' argument is false. California Insurance Code § 2071 does not dictate the contractual bargain between insurer and insured. Rather, the parties are free to bargain as they see fit, so long as the terms of the resulting contract are at least as favorable to the insured as are the model terms set forth in Section 2071. *See* Cal. Ins. Code § 2070 (insurer free to deviate from Section 2071 so long as the resulting contract, "when viewed in its entirety, is substantially equivalent to or more favorable to the insured than that contained in such standard form fire insurance policy"); *Maryland Cas. Co. v. Knight*, 96 F.3d 1284, 1293 (9th Cir. 1996) (same). Accordingly, the legislature left the selection of the contractual limitation period to the parties, subject only to the condition that such period be at least one year.

Legislatures set similar boundaries on many types of contracts, but that does not remove such contracts from the protection of the Contract Clause. For example, usury laws establish a maximum legal interest rate. But no one would contend that the act of setting a maximum interest

rate entitles a legislature to nullify contractual interest agreements at will, without Contract Clause review. Likewise here, the fact that California established a minimum contractual limitation period for insurance contracts does not mean that the legislature can retroactively nullify an agreed-upon contractual limitation period without Contract Clause scrutiny.

Put differently, the fact that a contract term is regulated by statute does not make it any less a contract term. Respondent cannot seriously contend that the insurance contract is not a contract, merely because it is partly regulated by statute. Although courts consider the existence of prior regulation in assessing the *degree* of impairment of a contractual right,[1] the existence of regulation does not remove contracts from the protection of the Contract Clause entirely.

The history of contractual limitation terms in insurance contracts makes respondents' argument especially inappropriate here. Insurers have included similar contractual limitation periods in policies since well before Section 2071 was enacted. Section 2071 simply placed California's statutory imprimatur upon this long-standing contractual practice:

> The short statutory limitation period . . . is the result of long insistence by insurance companies that they have additional protection against fraudulent proofs, which they could not meet if claims could be sued upon within four years as in the case of actions on other written instruments.

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[1] *See, e.g., Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983) ("In determining *the extent of* the impairment, we are to consider whether the industry the complaining party has entered has been regulated in the past.") (emphasis added).

> Originally, the shortened limitation periods were inserted into policies by insurers. Some courts declared such provisions void as against public policy while other courts enforced them in order to protect freedom of contract. In 1909, the California Legislature intervened in favor of a shortened period of limitation by enacting the predecessor to Insurance Code section 2071 to impose a 15-month limitation on claims under fire insurance policies.

Vu v. Prudential Property & Casualty Ins. Co., 26 Cal. 4th 1142, 1148 (2001) (citations and internal quotations omitted). In 1949, California gave insurers further contractual leeway by reducing the minimum limitation period to the current one year. *Id.* In light of this history, the one-year limitation provision in Section 2071 should not be viewed as imposing regulation upon insurers, but rather as a legislative judgment that the long-standing industry practice of including such contractual limitations is consistent with public policy.

Numerous cases agree that such a limitation provision, despite being codified, remains a contractual rather than a statutory deadline.[2]

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[2] *See Wetzel v. Lou Ehlers Cadillac Group Long Term Disability Ins. Program*, 222 F.3d 643, 647-48 (9th Cir. 2000) (courts "have consistently focused on the resulting policy provisions – rather than the statutes mandating their inclusion – and have found that the provisions create enforceable contractual limitations periods for bringing suit on an insurance contract."); *Great American West, Inc. v. Safeco Ins.*, 226 Cal.App.3d 1145, 1151 (1991) ("Limitations periods in insurance policies are not 'statutes' of limitation; they are contractual limitations on the insurer's liability."); *California Union Ins. Co. v. Poppy Ridge Partners*, 224 Cal.App.3d 897, 903 (1990) (policy's limitation period "is a bargained-for contractual one" and "is more personal than a statutory period of limitations");

(Continued on following page)

Finally, to accept respondents' argument would enable any legislature to avoid the Contract Clause entirely. A legislature wishing to invade contractual rights would need merely to first codify existing contractual rights. Thereafter, the contractual rights (under respondents' theory) would have to be considered statutory rights, and the legislature would be free to change those rights at will without regard to the Contract Clause.

IV.

SECTION 340.9 SUBSTANTIALLY IMPAIRS CONTRACTS

Respondents attempt to avoid the critical constitutional issue (whether Section 340.9 was reasonably tailored to its stated purpose) by arguing that Section 340.9 does not even satisfy the threshold requirement for review – that is, that Section 340.9 does not substantially impair contracts. Opposition, pp. 10-13. The Ninth Circuit, however, found the opposite, ruling that Section 340.9 does substantially impair contracts:

> Section 340.9 substantially impairs contracts between insurers and insured. It revives claims that would otherwise be barred by the contractual limitations period included in most insurance contracts pursuant to § 2071. It subjects the insurers to potential liability that they believed had long since been put to rest.

Ruffino v. Queen Ins. Co., 138 Cal.App. 528, 533 (1934) (contractual interpretation principles apply to statutory form policies).

App. 17. *Accord, Hellinger v. Farmers Group, Inc.*, 91 Cal.App.4th 1049, 1066 (2001). The Ninth Circuit's analysis in this respect is indisputably correct. When a law negates a contractual assurance of zero liability and burdens a party not only with liability but with substantial investigation and litigation expenses it had a contractual right to avoid, it is impossible to characterize the impairment as other than substantial.

Respondents' argument that Section 340.9 includes two temporal limitations (Opposition, pp. 11-12) does not lead to a different result because the temporal limitations do not substantially narrow the impact of Section 340.9. First, the fact that Section 340.9 is available only to persons who contacted their insurer about earthquake damage before January 1, 2000 is not a substantial limitation. Insurers received approximately 450,000 Northridge insurance claims,[3] essentially all of which are revived by Section 340.9.[4] Second, the fact that Section 340.9 allowed these 450,000 insureds only a one-year window in which to renew their claims is likewise not a substantial limitation. Thousands of claims, imposing industry-wide costs estimated at $500 million, have been renewed under the law. Amicus Brief of 21st Century Insurance Company, p. 1. By any measure, the impairment of contract is not merely substantial, but extreme.

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[3] Assem. Com. on Judiciary, Analysis of Sen. Bill No. 1899 (1999-2000 Reg. Sess.) as amended May 23, 2000, at 2 (http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_1851-1900/sb_1899_cfa_20000619_115754_asm_comm.html).

[4] In addition, Section 340.9 also revives contractual rights for insureds who did not actually file claims but who, even informally, "contacted" their insurer about potential earthquake damage before January 1, 2000. Cal. Ins. Code §340.9(a).

V.

THERE IS A SPLIT AMONG THE CIRCUITS CONCERNING THE THIRD PRONG OF THE *ENERGY RESERVES* TEST

Petitioner adopts and endorses the analysis of *amicus* 21st Century Insurance Company concerning the split among the circuits regarding the degree of deference courts must show to the legislature in applying the third prong of the *Energy Reserves* test. Amicus Brief of 21st Century Insurance Company, pp. 13-19.

The third prong of the *Energy Reserves* test requires the reviewing court to examine whether a law that substantially impairs contracts is based upon "reasonable conditions and of a character appropriate to the public purpose justifying [the legislation's] adoption." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-13 (1983). As *amicus* correctly points out, the Ninth and Eleventh Circuits have interpreted *Energy Reserves* to require such extreme deference to legislative judgment that judicial review of legislation affecting private contracts is rendered illusory in these circuits. Amicus Brief of 21st Century Insurance Company, pp. 13-19.

Addressing this split, respondents attack a straw man. Opposition, p. 15. Every circuit acknowledges that *Energy Reserves* requires some deference to a legislature's determination that a particular measure is reasonably tailored to its stated public purpose. Neither *amicus* nor petitioner contends otherwise. The split concerns not the need for deference, but rather the degree of deference.

Here, the Ninth Circuit recognized that – despite the legislation's stated purpose to protect insureds who had been misled – Section 340.9 "reviv[es] Northridge earthquake claims regardless of whether the insurance company has

been shown to have acted wrongly." App. 19. Section 340.9 is thus grossly overinclusive. To protect insureds who have been misled by some insurers in some claims, Section 340.9 strips the contractual right of repose from all insurers for all claims – merely by virtue of their status as insurers – without regard to culpability.[5]

Where there exists such an obvious conflict between the narrow stated goal of legislation and the broad means adopted, *Energy Reserves* requires the reviewing court to apply at least some scrutiny to that conflict. Yet this the Ninth Circuit never did. The Ninth Circuit never asked whether Section 340.9 could have accomplished its purpose without depriving all insurers of their contractual right of repose in all cases. It never asked whether there was some way that Section 340.9 could have included at least some requirement of proving deception. The Ninth Circuit, in short, failed to undertake any meaningful judicial review of that aspect of Section 340.9 – its overbreadth – that most obviously offends the Contract Clause.

In failing to review whether Section 340.9 is reasonably tailored to its stated purpose, the Ninth Circuit decided an important constitutional question of broad impact

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[5] Respondents incorrectly characterize 340.9 in this regard. Specifically, respondents state that Section 340.9 "allows insureds to bring claims without having *documentary* proof of being misled by insurers." Opposition, p. 17 (emphasis added). Respondents' use of the qualifier "documentary" implies that Section 340.9 requires an insured to present *some* proof (but not necessarily documentary proof) of being misled, and further implies that the Ninth Circuit relied upon this supposed proof requirement to find Section 340.9 constitutional. That is not the case. Neither Section 340.9 nor the Ninth Circuit opinion contains any discussion of "documentary" proof versus other types of proof. To the contrary, the Ninth Circuit recognized that – despite its stated purpose to protect insureds who had been misled – Section 340.9 requires absolutely no proof that an insured was in fact misled. App. 19.

in a way that conflicts with the controlling precedent of *Energy Reserves* and its predecessor cases. That failure of scrutiny reflects the Ninth Circuit's incorrect interpretation of *Energy Reserves*, detailed by *amicus*, as requiring almost complete deference to legislative decisions – an interpretation that has brought the Ninth Circuit into conflict with the majority of circuits that continue to recognize the need for the reviewing court to "undertake its own independent inquiry to determine the reasonableness of the law and the importance of the purpose behind it." *Mercado-Boneta v. Administracion Del Fondo de Compensacion Al Paciente*, 125 F.3d 9, 13 (1st Cir. 1997). Review by this Court is appropriate both to enforce the significant constitutional right, and to clarify the continuing post-*Energy Reserves* requirement for judicial scrutiny to ensure that legislation impairing contracts is reasonably tailored to accomplish the public purpose justifying the impairment.

CONCLUSION

For the foregoing reasons, as well as the reasons in the opening and *amicus* briefs, the Court should grant this petition.

Respectfully submitted,

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